

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE ENVIRONMENTAL	)	
SURCHARGE MECHANISM OF KENTUCKY	)	
UTILITIES COMPANY FOR THE SIX-MONTH	)	CASE NO.
BILLING PERIODS ENDING JANUARY 31, 2001,	)	2003-00068
JULY 31, 2001, JANUARY 31, 2002, AND	)	
JANUARY 31, 2003 AND FOR THE TWO-YEAR	)	
BILLING PERIODS ENDING JULY 31, 2000 AND	)	
JULY 31, 2002	)	

O R D E R

On March 17, 2003, the Commission initiated four 6-month reviews and two 2-year reviews of Kentucky Utilities Company's (KU) environmental surcharge as billed monthly to customers for the following periods: the 6-month periods August 1, 2000 to January 31, 2001; February 1, 2001 to July 31, 2001; August 1, 2001 to January 31, 2002; August 1, 2002 to January 31, 2003 and the 2-year periods August 1, 1998 to July 31, 2000 and August 1, 2000 to July 31, 2002.<sup>1</sup> Pursuant to KRS 278.183(3), the Commission must review, at 6-month intervals, the past operations of the environmental surcharge; after hearing, disallow any surcharge amounts that are not just and reasonable; and reconcile past surcharge collections with actual costs recoverable. At 2-year intervals, the Commission must review and evaluate the past

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<sup>1</sup> KU's surcharge is billed on a 2-month lag. Thus, surcharge billings for August 2000 recover costs incurred in June 2000, and every subsequent monthly surcharge billing under review recovers costs incurred 2 months prior to billing.

operations of the environmental surcharge and, after hearing, disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

The Attorney General, by and through his Office of Rate Intervention ( AG ), and the Kentucky Industrial Utility Customers, Inc. ( KIUC ) sought and were granted intervention in this proceeding. The Commission issued a procedural schedule that provided for the filing of testimony by KU and the intervenors, the issuance of data requests, and a prehearing informal conference. A public hearing was held on August 12, 2003.

At the request of KU, and with the agreement of the intervenors, a post-hearing informal conference was held on September 10, 2003. During that conference the parties reached an agreement in principle to settle all issues in this proceeding. In lieu of filing briefs, the parties filed, on October 2, 2003, a unanimous Settlement Agreement and requested approval by October 17, 2003.

### SURCHARGE REVIEW ISSUES

In its direct testimony filed on May 2, 2003, KU recommended the following items concerning its environmental surcharge:

- a. Approval of its determination that KU had a net over-recovery of \$3,735,587 for the six surcharge periods under review in this case.<sup>2</sup> KU also proposed to return the net over-recovery to ratepayers over 4 months, beginning with the first full billing month following the Commission's decision in this case.

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<sup>2</sup> The Commission had stated in the March 17, 2003 Order opening this case that since each of the periods under review may have resulted in over- or under-recoveries, the Commission would entertain proposals to adopt one adjustment factor to net all over- and under-recoveries.

b. Approval of a change in the surcharge mechanism from the incremental approach to the base-current approach. The base-current approach has been approved for the Louisville Gas and Electric Company.

c. In conjunction with the adoption of the base-current approach, the surcharge true-up adjustment, which addresses the timing differences between the calculation of the monthly surcharge factor and the application of the factor to customers bills, should be modified to better identify the impact on and correct timing differences in the surcharge.

d. Approval to incorporate into existing base rates, or roll-in, \$17,943,154 from the environmental surcharge. The roll-in would be spread equally to every tariff subject to the environmental surcharge.

e. The Base Period Jurisdictional Environmental Surcharge Factor ( BESF ) would be set at 3.03 percent, and reflect the proposed roll-in to base rates.

f. The rate of return<sup>3</sup> on the 1994 Compliance Plan component of KU s surcharge would be reset during the 6-month surcharge reviews, with that return reset in this case at 1.24 percent.<sup>4</sup>

In determining the net over-recovery, KU recognized an under-recovery of an operation and maintenance expense baseline ( O&M baseline ) that had been removed from the base rate revenue requirement calculations in Case No. 1998-00474.<sup>5</sup> The

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<sup>3</sup> The rate of return on the 1994 Compliance Plan component is the weighted average debt cost of KU s pollution control bond debt. The rate of return on the post-1994 Compliance Plan component is the overall jurisdictional weighted average cost of capital for KU, and it reflects long-term debt, short-term debt, accounts receivable financing, and common equity. Currently, the debt cost portions of the post-1994 Compliance Plan component are reset during the 6-month reviews, but debt costs of the 1994 Compliance Plan component are not.

<sup>4</sup> Response to the Commission Staff s First Data Request dated March 17, 2003, Item 29, page 2 of 2. The 1.24 percent reflects the weighted average debt cost of KU s pollution control bond debt as of January 31, 2003.

<sup>5</sup> Case No. 1998-00474, The Application of Kentucky Utilities Company for Approval of an Alternative Method of Regulation of Its Rates and Service, final Order dated January 7, 2000 and rehearing Order dated June 1, 2000.

O&M baseline had been established when the Commission approved KU's environmental surcharge in Case No. 1993-00465,<sup>6</sup> to reflect the O&M expense already in existing base rates. When the base rate revenue requirements were determined in Case No. 1998-00474, the O&M baseline was excluded from the calculations and there was no corresponding adjustment to the surcharge calculations. Thus, KU contended that it had not recovered the O&M baseline either in base rates or in the surcharge and that it was appropriate to include this under-recovery as part of the net over-recovery experienced during the surcharge review periods. On a going forward basis, the approval of KU's proposal to roll-in the environmental surcharge into existing base rates will resolve the O&M baseline issue for the surcharge filings submitted after the resolution of this proceeding.

The AG did not file testimony in this proceeding. KIUC's testimony focused primarily on its opposition to the inclusion of the O&M baseline adjustment in the determination of the net over-recovery. KIUC contended that the exclusion of the O&M baseline originated in a base rate proceeding and could be corrected only in a base rate proceeding. KIUC also argued that the O&M baseline included O&M expenses associated with environmental compliance projects that had been excluded from KU's surcharge recovery based on the Kentucky Supreme Court decision concerning the January 1, 1993 effective date of the environmental surcharge.

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<sup>6</sup> Case No. 1993-00465, The Application of Kentucky Utilities Company to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products, final Order dated July 19, 1994.

The main focus of the August 12, 2003 public hearing was the issue of the O&M baseline adjustment included in the net over-recovery calculations. In a post-hearing data request, KU provided additional information concerning the expenses reflected in the O&M baseline.

### SETTLEMENT AGREEMENT

The Settlement Agreement filed on October 2, 2003 resolves all issues in the surcharge review case. It also resolves the treatment of the O&M baseline issue in the next two 6-month environmental surcharge reviews. The Settlement Agreement provides for the following:

1. KU's cumulative over-recovery is \$6,922,047 and this amount shall be reduced by \$900,000 to reflect settlement of the inadvertent error resulting from the decision in Case No. 1998-00474 to exclude the O&M baseline. The \$900,000 represents KU's under-recovery of the Kentucky jurisdictional portion of the O&M baseline for the billing months of February 2003 through October 2003. KU will not seek recovery of the O&M baseline in subsequent environmental surcharge review proceedings.
2. The adjusted cumulative net over-recovery of \$6,022,047 will be returned to ratepayers through an adjustment of KU's monthly environmental surcharge factor over 12 months effective November 2003 through October 2004.
3. Beginning November 2003, KU's base rates shall be adjusted by KU's proposed incorporation of \$17,943,154 from the environmental surcharge. The incorporation of this amount into base rates will prospectively correct the O&M baseline error.
4. The parties recommend the approval of the base-current approach and the modification of the surcharge true-up mechanism as proposed by KU.
5. The pollution control bond debt rates used as the rate of return for KU's 1994 Compliance Plan component will be reviewed and reset during each environmental surcharge 6-month review.

6. The parties agree on how the roll-in and environmental surcharge operating expenses will be recognized in subsequent KU Earnings Sharing Mechanism calculations.

The Commission has reviewed the terms of the Settlement Agreement and finds that it represents a fair and reasonable resolution to the issues presented in this case. The use of the base-current approach with its true-up mechanism and the resetting of the rate of return on the 1994 Compliance Plan component should lessen the impact of timing differences on KU's over- or under-recovery of the environmental surcharge. The resolution of the O&M baseline issue eliminates the need to revisit the issue in subsequent environmental surcharge review proceedings. In light of the magnitude of the net over-recovery, the return of this amount over 12 months is reasonable. Therefore, the Commission will approve the Settlement Agreement as submitted.

#### REPORTING FORMATS

In conjunction with its proposal to change to the base-current approach, KU proposed revisions to its monthly environmental surcharge reporting formats.<sup>7</sup> The Commission has reviewed the proposed formats and finds they should be adopted, with the following modifications. On ES Form 1.00,<sup>8</sup> the section titled Calculation of Jurisdictional Environmental Surcharge Billing Factor, the calculation of the billing factor should reflect the combination of the 1994 Plan and Post-1994 Plan rather than

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<sup>7</sup> Response to the Commission Staff's First Data Request dated March 17, 2003, Item 57. During the prehearing informal conference, KU agreed to use the version of ES Form 2.30 Inventory of Emission Allowances as distributed at the informal conference. See Response to the Commission Staff's Second Data Request dated May 23, 2003, Item 7.

<sup>8</sup> Response to the Commission Staff's First Data Request dated March 17, 2003, Item 57, page 2 of 12.

continue the separation. Similarly, on ES Form 2.00,<sup>9</sup> the section titled Over/Under Recovery of Monthly Surcharge Due to Timing Differences, the calculation should reflect the combination of the 1994 Plan and Post-1994 Plan rather than continue the separation. The reporting formats as modified herein should be approved for use with KU's next monthly surcharge filing.

#### TARIFF ISSUE

KU did not propose to amend its environmental surcharge tariff in this proceeding. However, the adoption of the base-current approach adds an additional calculation to the surcharge mechanism, the determination of the Monthly Billed Environmental Surcharge Factor ( MESF ). MESF is calculated by subtracting the base period surcharge factor from the current period surcharge factor and is expressed by the following formula:

$$\text{MESF} = \text{CESF} - \text{BESF}$$

CESF is the Current Period Environmental Surcharge Factor. The remaining formulas and calculations currently used by KU to determine its monthly environmental surcharge remain unchanged.

The Commission finds that KU should amend its environmental surcharge tariff to reflect the adoption of the base-current approach and the addition of the MESF calculation.

IT IS THEREFORE ORDERED that:

1. The October 2, 2003 Settlement Agreement among KU, the AG, and KIUC is approved in its entirety as a reasonable resolution of all issues raised in this case.

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<sup>9</sup> Id., page 3 of 12.

2. The monthly environmental surcharge reporting formats proposed by KU, and modified herein, are approved for use with KU's next monthly surcharge filing.

3. Within 20 days of the date of this Order, KU shall file with the Commission its revised environmental surcharge tariff setting out the revisions resulting from the adoption of the base-current approach.

4. The rate of return on the 1994 Compliance Plan component of KU's surcharge shall be 1.24 percent.

5. The BESF for KU's environmental surcharge calculations is 3.03 percent.

6. KU's Motion to Cancel the submission of briefs is denied as moot due to the filing of the October 2, 2003 Settlement Agreement.

Done at Frankfort, Kentucky, this 17<sup>th</sup> day of October, 2003.

By the Commission

ATTEST:

  
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2003-00068 DATED OCTOBER 17, 2003

October 2, 2003 Settlement Agreement

(See document named 200300068\_10172003apx.pdf for Settlement Agreement)